

Bankruptcy's New Subchapter V: Small Business Reorganization With Fewer Financial and Procedural Burdens

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It is often commented that Chapter 11 bankruptcy is too complicated, expensive, and slow to provide meaningful relief for small businesses. And, while the Bankruptcy Code has contained “small business” debtor provisions for many years, those provisions have been often criticized as not significant enough in scope or concept to help small business debtors survive. To remedy these issues Congress enacted the Small Business Reorganization Act which went into effect in February 2020. This added “Subchapter V,” 11 U.S.C. §§ 1181-95, to Chapter 11 of the Bankruptcy Code. Subchapter V provides eligible debtors with a less costly and more streamlined Chapter 11 path. Some of the key cost-saving features of Subchapter V are: (i) waiver of quarterly U.S. Trustee fees; (ii) absence of an official committee of unsecured creditors; and (iii) debtor’s right to spread the payment of administrative expenses (including its attorneys’ fees and that of the Subchapter V trustee) over the life of the plan.

Initially, Subchapter V eligibility was limited to small business and individual debtors (except for businesses that are single-asset real estate ventures) engaged in commercial or business activities with aggregate liquidated and non-contingent secured and unsecured debts of \$2,725,625 (exclusive of debts owed to insiders or affiliates), at least half of which arose from the debtor’s commercial or business activities. As part of the response to the COVID-19 pandemic that has devastated many small businesses, Congress temporarily

raised the debt eligibility threshold to \$7.5 million. The exclusion from the debt limits of debts owed to insiders and/or affiliates is intended to allow more closely held businesses — the largest creditor of which often is a founder or insider — to enjoy the benefits of Subchapter V.

Unlike a traditional Chapter 11 case where a trustee is seen as an “extraordinary remedy,”² a trustee is immediately appointed upon a Subchapter V filing. The primary role of the Subchapter V trustee is to coordinate with the debtor and its creditors to facilitate the development of a consensual plan of reorganization (just like a mediator would facilitate a settlement in a litigation).³ Unless otherwise ordered by the bankruptcy court, operations of the debtor’s business are left to existing management; so Subchapter V debtors need not be worried about losing control of the case or their operations to the trustee. Although the Subchapter V trustee has a more limited role than most other bankruptcy trustees, there are key duties that must be fulfilled. The Subchapter V trustee is tasked with overseeing key aspects of the proceeding, including examining each claim filed in the case (and objecting if needed), participating in confirmation, and facilitating the smooth administration of the Subchapter V bankruptcy.

Subchapter V cases are meant to move quickly. Within 60 days of filing a Subchapter V case, the court is required to hold a status conference “to further the expeditious and economical resolution” of the case. At least 14 days before the status conference, the

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debtor must file a written report detailing the efforts taken, and that will be taken, to get to a consensual plan of reorganization. The Subchapter V debtor is required to file its reorganization plan within 90 days of the bankruptcy filing, which the court may extend only if the debtor shows that the “need for the extension is attributable to circumstances for which the debtor should not be justly held accountable.”⁴ Bankruptcy courts have not yet established a consistent standard here, and generally apply a “case by case” analysis. Subchapter V further streamlines the plan process by not requiring the debtor to file a separate disclosure statement. Instead, the debtor is merely required to include in its plan a brief history of its operations, a liquidation analysis (comparing the distribution to creditors under the plan with those in a projected liquidation), and projections supporting the ability of the debtor to make payments under the proposed plan.

Other important distinctions between Subchapter V and Chapter 11 include, that a Subchapter V debtor need not obtain creditor consent on its plan as long as the plan devotes all of the debtor’s “projected net disposable income” for a period of three to five years to payments due to creditors under the plan. Also, the Subchapter V plan need not comply with the “absolute priority rule,” which requires creditors be paid in full for owners of the debtor to retain their ownership of the debtor.

A further benefit of Subchapter V is that the plan may modify a mortgage on the debtor’s or its equity owner’s primary residence where the proceeds of such mortgage were “used primarily in connection with the small business of the debtor.” Under other chapters of the Bankruptcy Code, debtors are greatly limited in their rights to impair or otherwise modify a home mortgage.

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of bankruptcy protection especially with the debt ceiling increase provided by the CARES Act making for wider eligibility. Subchapter V may be the saving grace that business owners need to bounce back in the aftermath of the COVID-19 crisis.⁵ Since the one-year enactment, over 2,000 Subchapter V cases have been filed and such filings continue to grow.⁶ This novel subchapter is still developing its case law, as courts continue to grapple with its new, and sometimes inconsistent, provisions. One frequent issue, which has seen a split among the courts, is the eligibility of an existing bankruptcy debtor to re-designate or convert its existing case to a Subchapter V case. A number of bankruptcy courts, including in New York, West Virginia, and New Mexico, have allowed existing debtors to amend their filings to convert to Subchapter V, finding nothing in the Bankruptcy Code that prevents a debtor from amending its petition and re-designating its case to Subchapter V.⁷ However, at least two other courts have reached different conclusions.⁸ Another area of contention among the courts is whether a Subchapter V debtor must be “currently” engaged in business in order to qualify for Subchapter V. In *In re Wright*⁹ the bankruptcy court held that restructuring the debt of a defunct business was enough for Subchapter eligibility. Other courts however have ruled that debtors not currently engaged in a commercial or business activity are ineligible for Subchapter V.¹⁰

As can be expected given that Subchapter V is relatively new, these and other fundamental Subchapter V issues will continue to be subject to litigation and interpretations by the courts. One thing is clear, however — Subchapter V appears to be achieving its purpose of streamlining small business bankruptcies and making it easier for such debtors to reorganize their failing businesses. Thus, as pandemic-related relief for small businesses expires, Subchapter V provides another much-needed option for relief. Ⓞ

Notes:

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2. *In re Marvel Entertainment Group*, 140 F.3d 463,471 (3d Cir. 1998).
3. 11 U.S.C. § 1183(b).
4. 11 U.S.C. § 1189.
5. Horn, Chad Van. “Subchapter V of Chapter 11 Bankruptcy – A Boon for Small Business Financial Recovery.” Day Law Library. Day Law Library, February 19, 2021. <https://www.daylawlib.org/legal/subchapter-v-of-chapter-11-bankruptcy-a-boon-for-small-business-financial-recovery>.
6. See <https://www.abi.org/sbra>.
7. See <https://www.abi.org/newsroom/daily-wire/west-virginia-judge-allows-conversion-to-subchapter-v-after-deadlines-passed>.
8. See *In re Seven Stars on the Hudson Corp.*, 618 B.R. 333 (Bankr. S.D. Fla. 2020) and *In re Wetter*, 620 B.R. 243 (Bankr. W.D. Va. 2020).
9. 2020 WL 2193240 (Bankr. D.S.C. April 27, 2020).
10. See e.g., *In re Offer Space, LLC*, Case No. 20-27480 (Bankr. D. Utah. Apr. 22, 2021 (Doc. 50)).